

The Treasury

Best Sourcing: Improving Procurement Across Government

Information Release

3 May 2013

Release Document

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Treasury Report: Best Sourcing: Improving Procurement Across Government

Date:	14 December 2012	Report No:	T2012/3257
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Indicate if you wish to discuss the contents of this report.	None.
Associate Minister of Finance (Hon Steven Joyce)	Note the contents of this report.	None.
Minister of State Services and Associate Minister of Finance (Hon Dr Jonathan Coleman)	Note the contents of this report.	None.

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Tony Burton	Principal Analyst, State Sector Management	917 6053	[1]	✓
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[1]				
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Minister of Finance's Office Actions (if required)

None.

Enclosure: **Yes.**

Treasury Report: Best Sourcing: Improving Procurement Across Government

Executive Summary

Best Sourcing is about agencies working as effectively and cost effectively as possible, using whichever combination of government, NGO or private provision achieves this outcome. In June 2012, the Better Public Services (BPS) Best Sourcing work stream updated you on work we are doing on improving contracting practice (T2012/1250 refers). This report responds to your request for an overview of procurement of external services across government and identifies actions for you to support this work.

To respond to your request, we have analysed expenditure in the Crown Financial Statements. As of financial year 2011/12, procurement accounted for approximately \$24 billion, or 32%, of total departmental and non-departmental operational expenditure across the state services. Consistently over the last ten years, a third of government expenditure has been spent on procurement, a figure that is high by international standards (this fact was reinforced by a recent survey of Australian Treasuries). The social sector accounts for approximately 52% of the procurement spend.

This report uses newly available information on agency procurement in financial year 2011/12 to provide a benchmark for government procurement. The analysis suggests there is value in improving the transactional elements of procurement and provides evidence of a lack of procurement capability in the state sector.

Subsequent to your report request, MBIE has been tasked with leading on ways to improve the practice of procurement within government agencies. In particular, they have been given the Procurement Functional Leadership (PFL) for:

- i. strengthening and accelerating the current government procurement reform programme;
- ii. providing stronger and broader uptake of initiatives;
- iii. introducing a stronger centre-led model;
- iv. providing clear accountability for delivery of procurement commercial results;
- v. supporting greater collaboration across state services agencies; and
- vi. improving oversight and support for agency procurement.

In addition, the Government has initiated a wide ranging work programme to improve procurement, including the testing of new contracting models through PPP contracts, Social Sector Trials, Partnerships Schools and a Social Finance Initiative.

However there are three areas where further action may be appropriate:

- closer alignment of the work on procurement with the BPS Results in the social welfare, health and education sectors;
- active leadership to create better incentives and use contestability where it leads to greater benefits being derived from procurement; and
- active leadership to ensure new models of procurement are used when appropriate.

[2]

Therefore, we recommend:

- that Ministers with social sector portfolios be included in the next report back in March 2013 on progress with MBIE's work programme as PFL, and on an ongoing basis if deemed appropriate; and
- that the role for Treasury in procurement is to support the Minister of Finance and his colleagues by:

[2]

- ii as part of the Corporate Centre, assisting MBIE to identify new opportunities to develop procurement tools (e.g. Social Finance Initiatives) and promote contestability in the delivery of public services.

Recommended Action

We recommend that you:

Scope and scale of procurement

- a. **note** the level of procurement of external services by departments and Crown entities has been broadly stable over the last decade at around 32% of total departmental and non-departmental operating expenditure
- b. **note** that the social sector accounts for approximately 52% of procurement expenditure
- c. **note** that by international standards New Zealand has a high level of external procurement and international interest in increasing external sourcing reflects other countries moving towards the New Zealand approach

- d. **agree** that, because of New Zealand's comparatively high level of external procurement, the focus should be on:
 - i lifting the performance of existing procurement activity; and
 - ii selectively identifying new opportunities to introduce new contracting mechanisms and improved contestability into current procurement practice;

Improving procurement practice

- e. **note** there is weak capability within government to design and implement effective contracting for both value for money and better outcomes
- f. **note** that data from MBIE's agency procurement survey indicates that for small procurements a large number of suppliers do not have a formal contract
- g. **note** that as the Procurement Functional Lead (PFL) MBIE has been given the mandate to improvement procurement across government [CAB Min (12) 35/40]. In particular, they have been given the Procurement Functional Leadership for:
 - i. strengthening and accelerating the current government procurement reform programme;
 - ii. providing stronger and broader uptake of initiatives;
 - iii. introducing a stronger centre-led model;
 - iv. providing clear accountability for delivery of procurement commercial results;
 - v. supporting greater collaboration across state services agencies; and
 - vi. improving oversight and support for agency procurement;
- h. **note** that as PFL, MBIE has initiated a wide ranging programme to improve procurement practice including building capability and reducing transaction costs
- i. **note** that MBIE, within their mandate as PFL, is working to improve procurement practice in social sector agencies
- j. **note** that there are a wide range of other initiatives across government to improve procurement, including the testing of new contracting models through PPP contracts, Social Sector Trials, Partnerships Schools and a Social Finance Initiative

Next steps

- k. **agree** further action is needed to improve procurement through:
 - i. closer alignment of the work on procurement with the Better Public Services Results in the social welfare, health and education sectors;
 - ii. active leadership to create better incentives and use contestability where it leads to greater benefits being derived from procurement; and

- iii. active leadership to ensure new models of procurement are used when appropriate.
- l. **note** that SEC and BPS Ministers receive quarterly updates on progress with MBIE's work programme as PFL;
- m. **agree** that Ministers with portfolios in the social welfare, health and education sectors should be included in the next report back in March 2013 on progress with MBIE's work programme as PFL, and on an ongoing basis if deemed appropriate;
- n. **agree** that the role for Treasury in procurement is to support the Minister of Finance and his colleagues by:

[2]

- ii. as part of the Corporate Centre, assisting MBIE to identify new opportunities to develop procurement tools (e.g. Social Finance Initiatives) and promote contestability in the delivery of public services.

Fiona Whiteridge
Manager, State Sector Management

Hon Bill English
Minister of Finance

Treasury Report: Best Sourcing: Improving Procurement Across Government

Purpose of the Report

1. In June 2012, the Better Public Services (BPS) Best Sourcing work stream updated you on work we are doing on improving contracting practice (T2012/1250 refers). This report responds to your request for an overview of procurement of external services across government and identifies actions for you to support this work.

Background

Best Sourcing Work Stream

2. There are three work streams underway within the BPS programme to drive improved procurement practices:
 - i. The Ministry of Business, Innovation & Employment (MBIE) has been assigned as the Functional Lead for Procurement;
 - ii. Government Procurement Policy Transformation, an MBIE-led project to consolidate all government procurement policy; and
 - iii. The Best Sourcing work stream is led by Treasury.
3. Best Sourcing is about agencies working as effectively and cost effectively as possible, using whichever combination of government, NGO or private provision to achieve this outcome. This work stream aims to strengthen current procurement practices and to inform future work on the introduction of additional contestable processes and procurement innovations in the state sector. This work stream has:
 - undertaken analysis of the Crown Financial Statements to provide an overview of total spend across government on non-government and private providers and how this spend has changed over the last ten years (Annex A provides detail of the proxy);
 - surveyed Australian State Treasuries to provide a benchmark for the overall level of government procurement and to identify recent trends in procurement practice;
 - worked with the MBIE to provide analysis of agency procurement spend, utilising the data gathered in a recent joint MBIE/Treasury survey regarding government procurement practices;

- undertaken a stock take of procurement initiatives across New Zealand government, (the summary is attached as Annex B);
- worked as part of the cross-agency project team (led by MBIE) to streamline NGO contracting. MBIE delivered a report to BPS Ministers on the results of the project on 30 November 2012;
- funded seminars to socialise the objectives of the streamlining NGO contracting project with the NGO sector (in Auckland, Wellington and Christchurch) led by the Association of Non-Governmental Organisations of Aotearoa (ANGOA); and
- commissioned a report by ANGOA on NGO contracting, titled '*Ways to Enhance the Contracting Environment between the Community Sector & Government*' (attached as Annex C).

Better Public Services and Procurement

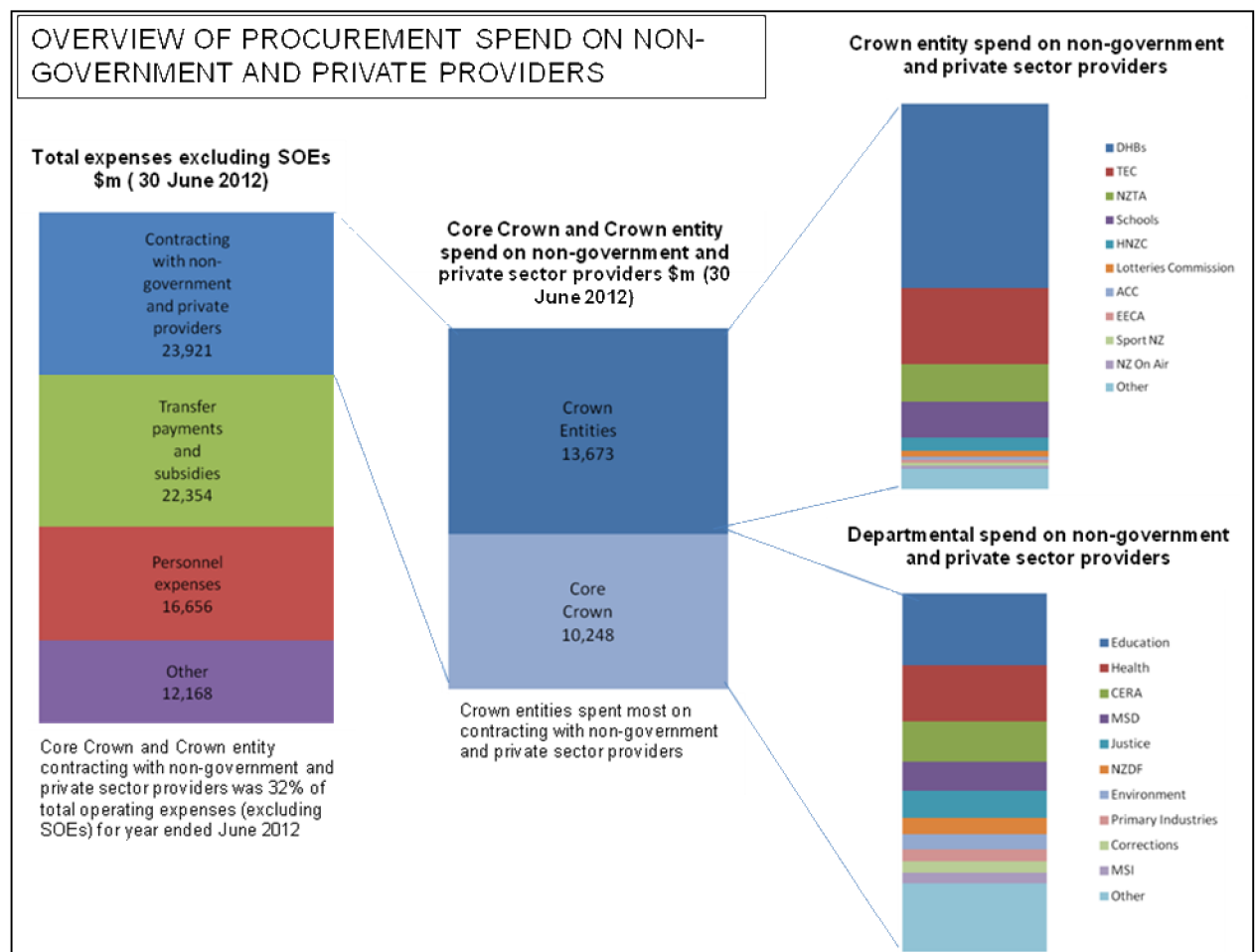
4. The Government's Better Public Service targets have driven a need to understand how well government agencies are delivering on outcomes. In particular, to meet the Government's fiscal targets there needs to be close scrutiny of the effectiveness of programmes to ensure money is well targeted.
5. Within the Better Public Services work programme, MBIE has been tasked with leading on ways to improve the practice of procurement within government agencies. In particular, they have been given the Functional Lead for procurement with the intention of:
 - i. strengthening and accelerating the current government procurement reform programme;
 - ii. providing stronger and broader uptake of initiatives;
 - iii. introducing a stronger centre-led model;
 - iv. providing clear accountability for delivery of procurement commercial results;
 - v. supporting greater collaboration across state services agencies; and
 - vi. improving oversight and support for agency procurement.

Procurement in New Zealand

6. MBIE uses the term *procurement* to cover all expenditure to third parties used for the acquisition and delivery of goods, services and construction. Procurement accounts for approximately \$24 billion, or 32%, of expenditure per annum across the state services. The following figure shows how this expenditure was organised in financial year 2011/12.¹

¹ Data from Budget 2012. This excludes activity by SOEs.

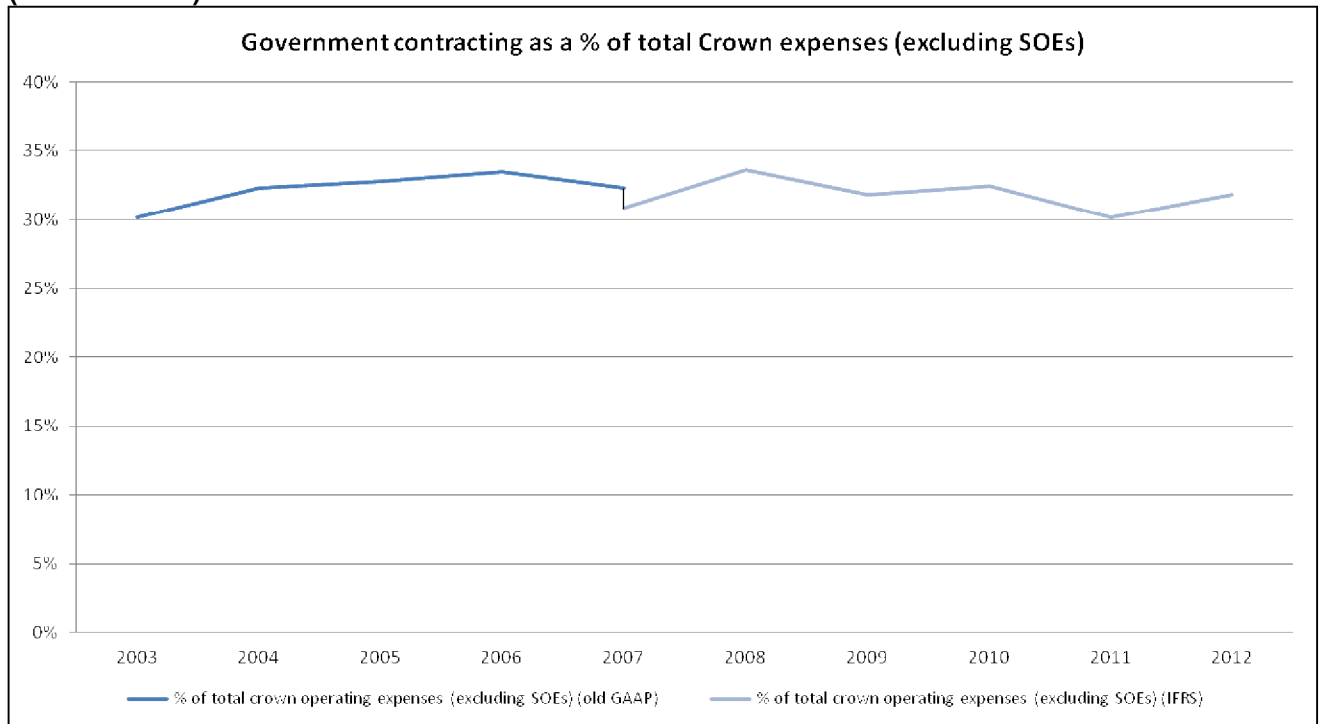
Figure 1: Government spend on procurement from non-Crown providers \$m (as of 30 June 2012)



7. Crown Entities have the largest procurement spend in the government sector, just under half of which is accounted for by the 20 DHB's which has \$6.5 billion of procurement spend in 2011/12. The public service departments with the highest procurement spend were:
 - Ministry of Education of \$2.0 billion;
 - Ministry of Health of \$1.6 billion;
 - CERA \$1.4 billion; and
 - Ministry of Social Development of \$0.8 billion.
8. Procurement by social sector agencies was approximately \$12.4 billion, or 52% of total procurement spend.

9. Over the last ten years, procurement expenditure showed a nominal increase from \$14 billion in 2002/03 to \$24 billion in 2011/12. However overall nominal government expenditure increased from \$46 billion in 2002/3 to \$75 billion in 2011/12; so procurement remained a broadly stable proportion of government expenditure over the ten year period (see the following figure).

Figure 2: Government procurement as a % of total expenses excluding SOEs (2003 to 2012)

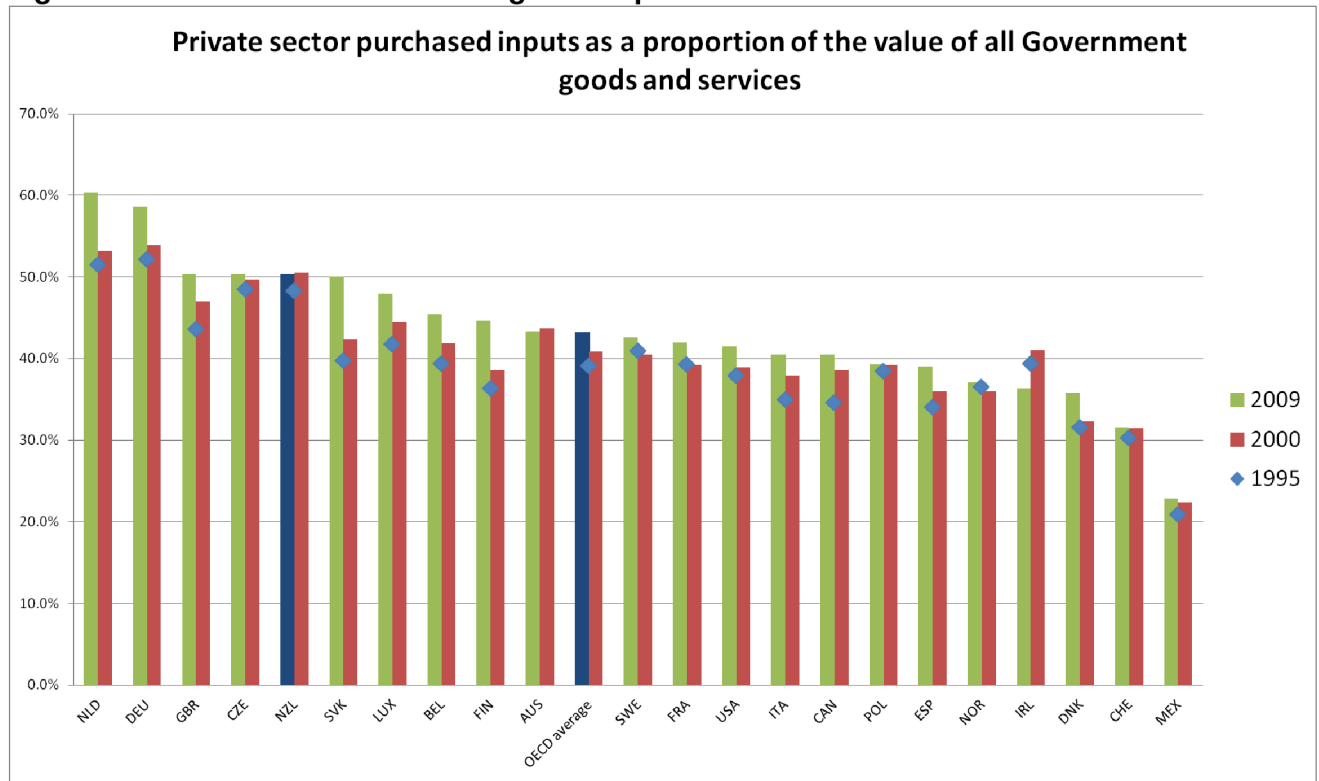


International Comparisons and Procurement

10. OECD data indicates New Zealand has comparatively high levels of procurement expenditure and since 1995 countries have been increasing their level of procurement towards New Zealand's level.²

² Source: OECD Government at a Glance, 2011. The OECD estimate excludes transfer payments and subsidies so Figure 3 shows procurement to be a higher proportion of remaining government expenditure.

Figure 3: New Zealand's Outsourcing in Comparison to the OECD



11. International interest in increasing procurement levels reflects other countries moving towards our current level of procurement as a percentage of total expenditure. New Zealand's comparatively high level of procurement suggests the greatest gains are to be had through lifting the performance of existing contracting activity, while selectively identifying new opportunities to introduce contracting innovations (e.g. Social Finance Initiatives) and promote contestability in the delivery of public services.
12. In November 2012, we surveyed Australian State Treasuries and hosted a discussion on contestability to compare overall levels of government procurement and to identify recent trends in procurement practice. The following themes were identified in the survey:

Policy direction	There is a broad policy commitment to increased contestability and procurement across governments
Scope and scale of procurement	For most governments the proportion of expenditure spent on procurement has been broadly flat over recent years (where data capture was available). New Zealand had a comparatively high level of procurement
Non government	Work to expand service delivery and get more robust procurement with the sector is occurring in a number of governments
Public Private Partnerships (PPPs)	PPPs are utilised as a tool across most governments, in key infrastructure such as schools, hospitals, prisons, and housing
Capability and expertise	Similar investment across governments in improving procurement practice, including enhancing procurement expertise, strategies for non government service delivery, standardisation and guidance

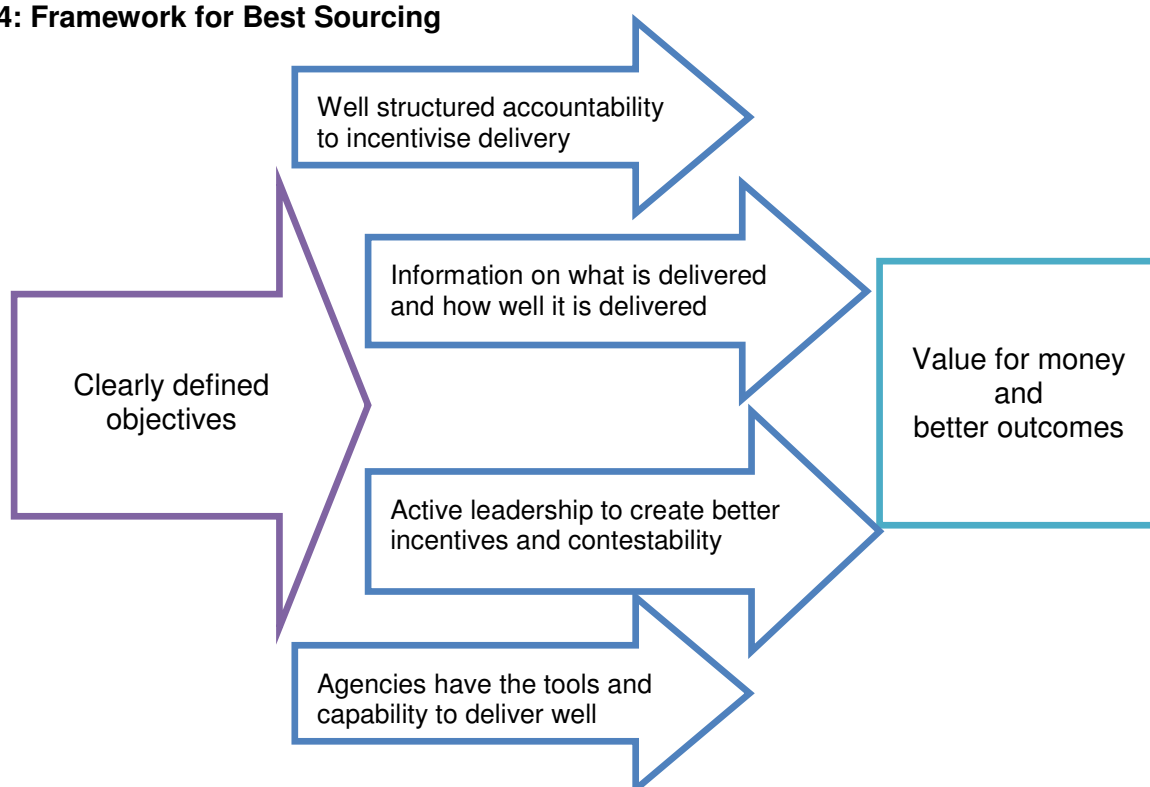
13. Data from the Australian Treasuries echoed the OECD analysis in showing New Zealand has a comparatively high level of external procurement. With regard to the discussions around initiatives to improve contestability, the Australian Treasuries noted that New Zealand was more advanced in efforts to improve procurement practice, in particular shifting towards an outcomes focus in contracting.

Benchmarking the State of New Zealand Procurement

Framework

14. For effective service delivery, agencies need a good sense of what they should be delivering, to have the tools and capability to deliver, require information about how well they are delivering, and they need the incentives to use the information and tools to improve delivery where necessary. When a service is procured under these conditions, it will be *best sourced* in the sense that the agency will use whichever combination of government, NGO or private provision means it is working as effectively as possible.
15. In practice, Ministerial and agency leadership is also required to ensure agencies are willing to innovate and that lessons are passed on. This is particularly the case where best sourcing requires agencies to make services contestable.

Figure 4: Framework for Best Sourcing



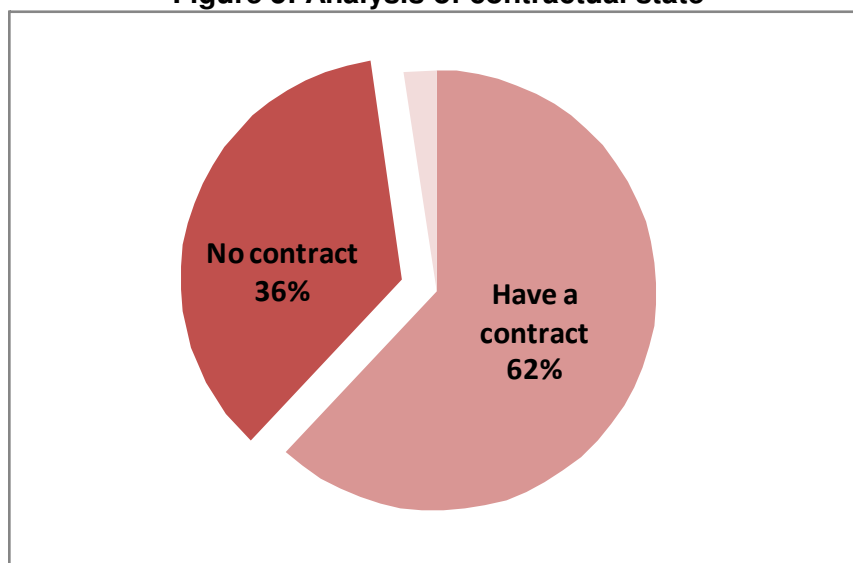
16. We focus on detailed information on agency procurement data for 2011/12 that has recently become available. This is an opportunity to set a benchmark for the

state of government procurement and to identify further actions to improve the public sector's delivery of services.

Analysis of Data

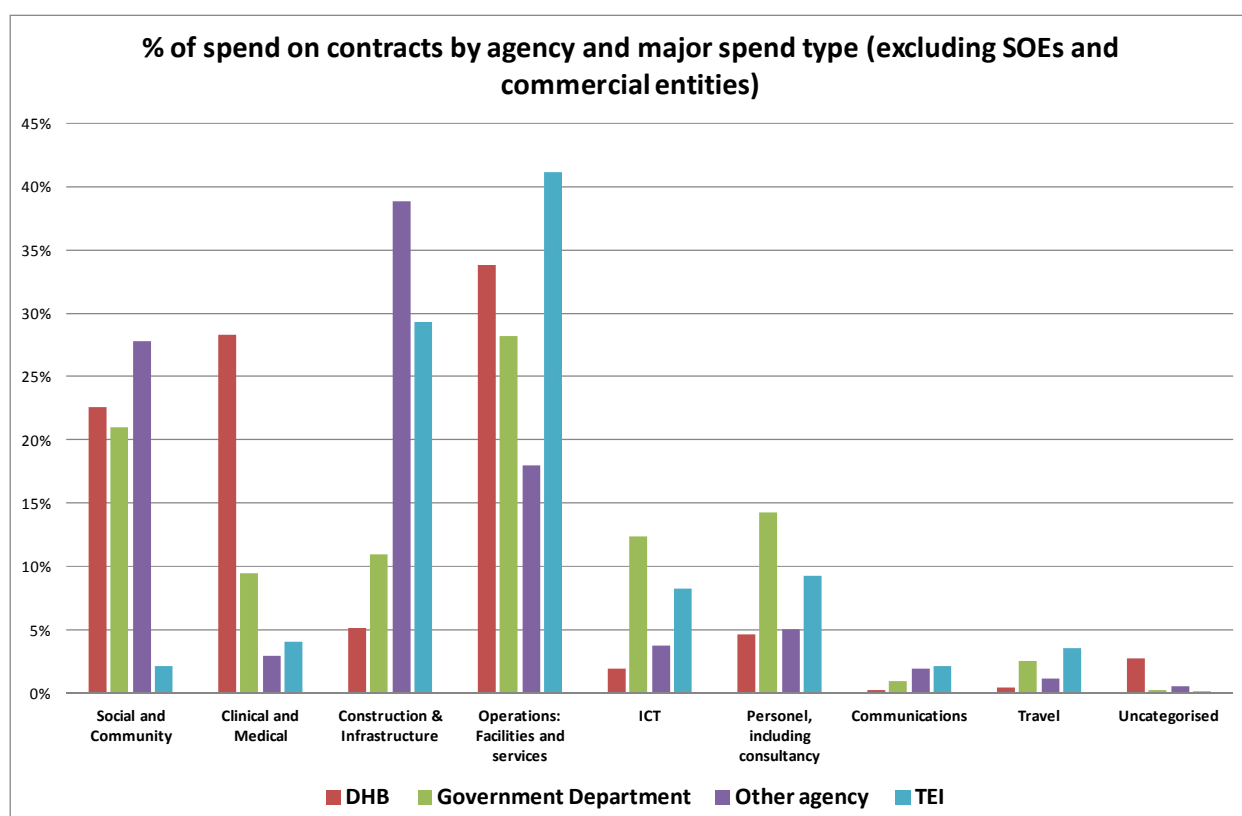
17. In July 2012 a survey of operational expenditure was sent to 190 agencies in the state services including District Health Boards (DHBs) requesting them to provide spend data on third party goods and services for the 2011/12 financial year. A total of 161 agencies responded to the request which accounted for an 85% response rate. This data allows us to understand the state of agency procurement prior to MBIE taking on the role of Procurement Functional Lead. While the number of schools made it impracticable to include them in the survey, it allows us to understand the type and level of spend for most government organisations; the type of spend by sector; and the number of contracts held by each agency.
18. One striking result from the survey is the limitations of the data available from this survey which to date is our most comprehensive information gathering instrument of procurement practice. This is because:
 - a number of agencies included their tax payments as 'procurement expenditure' when filling out the form;
 - the scale of payments for building and construction suggest some included capital expenditure (which was explicitly excluded); and
 - as the graph below shows, based on a sample 2500 contracts, just over a third of procurement transactions did not have a contract. While this tended to be for procurement of lower value, the average value of a non-contractual procurement was approximately \$13,000.

Figure 5: Analysis of contractual state



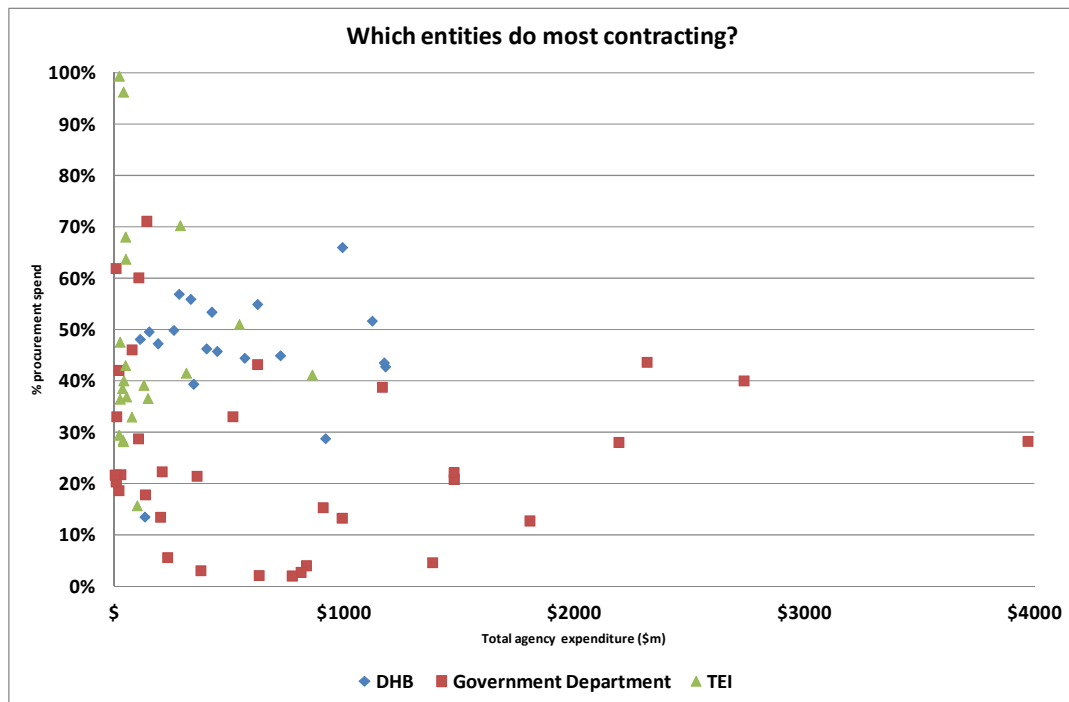
19. Clearly the first two examples (in the prior paragraph) are mistakes by those returning the form. However, overall survey quality suggests either that the capability to identify procurement spend does not exist or, more likely, that procurement is a low priority and agencies put a low priority on understanding their own procurement practice. The high proportion of procurement transactions without a contract is evidence of a lack of interest in best practice procurement.
20. Turning now to the services procured, the following figure shows the range of service procurement by different types of government agency.

Figure 6: Government procurement as a % of spend on contracts by agency and major spend type



19. Most striking is the importance of procurement for services delivered to agencies. In comparison, services for the public are much more likely to be internally staffed. The social, health and education sectors are the most important frontline services for the public. While there is clearly value in introducing commercial disciplines to the procurement of these services, for improvements in procurement to be substantive, cross government procurement policy needs a focus on frontline social sector services and to have a strong input from those responsible for delivering frontline services.
21. Of further interest is the contrast between DHB and government department spend on IT and human resources services. Health, human resources and IT tend to be highly specialist and of the type that would be expected to need external contractors, yet they have considerably lower spend. Further work is needed to understand this.

Figure 7: Entity Procurement Levels



21. The graph above shows the proportion of agency expenditure by total expenditure. While there is individual variation, the agencies at arm's length from government, DHBs and TEIs, spend on average 20% more on external procurement than government departments. As service delivery organisations, this difference is unsurprising. However, this does give a likely 'upper bound' for government departments' external procurement and suggests that departments with substantial service delivery arms, such as identity services and job search, may have opportunities to increase external procurement.
22. The following table shows the number of contracts by looking at a sample of agencies' procurement with particular firms. Given that over 5000 contracts are for a value less than \$1 million, it shows the wide scope for integrated government contracts to minimise transaction costs.

Figure 8: Number of contracts verses the magnitude of spend

[3]

23. Finally, the table below shows the main suppliers listed by the agencies. As noted below, the inclusion of Inland Revenue suggests some uncertainty in the understanding of procurement spend.

Figure 9: Analysis of contract spend by firm

[3]

24. In summary, the analysis of the data identifies that there is value in improving the transactional elements of procurement and that there is evidence of a lack of capability within the state sector. Therefore, it emphasises the importance of the work that MBIE is undertaking as Procurement Functional Lead (as detailed in the next section) regarding steps to address the procurement capability issues.

Summary of current initiatives

MBIE's Role

25. MBIE has been given the primary role in government procurement as Procurement Functional Lead. In this role MBIE has undertaken a number of initiatives, including to:
- i. Increase performance, add value and maximise results*
 - undertake independent reviews of commercial and procurement capability, using the data to create a Procurement Maturity Index so CEs can assess agency performance;
 - establish a deployable pool of commercially experienced procurers to support agencies; and
 - oversee comprehensive agency procurement plans/forecasts for all procurements with a contract value greater than \$5 million.
 - ii. Unlock cost savings and lower transaction costs*
 - MBIE has led a programme of All-of-Government contracts. These contracts, along with cultural change, are projected to drive \$353 million in projected savings over the respective lives of the contracts. MBIE is looking to expand these contracts: audit, accounting, consulting services and insurance are being considered.
 - greater use of syndicated contracts, where a number of agencies join-up to go to market for similar needs.
26. MBIE will report on its progress as Procurement Functional Lead to State Sector Reform Ministers in March 2013 and will also provide quarterly updates to SEC and to BPS Ministers. MBIE has a significant work programme and the Treasury will continue to work collaboratively on a cross agency project basis to assist MBIE's deliverables.

Other initiatives to improve procurement across government

27. Additionally, there are a number of other initiatives underway across government to improve procurement (see Annex B). The following table summarises initiatives to improve contracting across government according to our Best Sourcing framework:

Incentives aligned with outcomes	Information on delivery	Contracting innovations	Tools and capability
<ul style="list-style-type: none"> • Procurement policy framework (MBIE) • Investing in Services for Outcomes (MSD) 	<ul style="list-style-type: none"> • Review of procurement plans and business cases (MBIE) 	<ul style="list-style-type: none"> • PPPs (Education, Corrections, NZTA) • Welfare reform initiatives (cohort trials, youth services, case management) (MSD) • Social sector trials (MSD) • Whanau Ora (MSD) • Investing for Social Success (Health) • Partnership Schools (Education) • Payment by results for reintegration centres (Corrections) • All-of-Government contracts (MBIE) • Syndicated contracts (MBIE) • Better value from key suppliers (MBIE) • Social Finance Initiative (MoH) 	<ul style="list-style-type: none"> • Procurement capability reviews and maturity index (MBIE) • Deployable commercial pool of procurers (MBIE) • Streamlined NGO contracts (MBIE) • Contracting centre of expertise (ACC)

28. Some of these initiatives have made useful progress, such as the NGO streamlining project to develop common performance and compliance measures where the expansion of the project is currently under active consideration by Ministers. This MBIE-led project was a good example of collaboration in a cross-agency project team. Additionally, for your information we have attached a Treasury commissioned report by ANGOA on NGO contracting, (used as input into the NGO streamlining project) titled '*Ways to Enhance the Contracting Environment between the Community Sector & Government*' (attached as Annex C).
29. Others initiatives like Partnership Schools and Investing for Social Success are still in the early stages of development.

Initiatives to improve procurement: where is further action needed?

30. The largest gaps in initiatives to improve procurement relate to work on:
- closer alignment of the work on procurement with the BPS Results in the social welfare, health and education sectors;
 - active leadership to create better incentives and use contestability where it leads to greater benefits being derived from procurement; and

- active leadership to ensure new models of procurement are used when appropriate.

[2]

Active leadership to create better incentives and contestability

[2]

- that Ministers with portfolios in the social welfare, health and education sectors should be included in the next report back in March 2013 on progress with MBIE's work programme as Procurement Functional Lead, and on an ongoing basis if deemed appropriate;
- that the role for Treasury in procurement is to support the Minister of Finance and his colleagues by:

[2]

- ii. as part of the Corporate Centre, assisting MBIE to identify new opportunities to develop procurement tools (e.g. Social Finance Initiatives) and promote contestability in the delivery of public services.

ANNEX A: PROCUREMENT PROXY'S COMPOSITION (AS OF 30 JUNE 2012)

	<i>Core Crown</i>	<i>Crown Entities</i>	30 June 2012 Total Crown
	\$m	\$m	\$m
Grants & subsidies (1)	1,839	1,841	3680
Fees paid to audit firms (2)	1	2	3
Inventory expenses (3)	206	203	409
Rental and leasing costs (4)	422	299	721
Other operating expenses (5)	7,780	11,328	19108
Procurement proxy	10,248	13,673	23,921
Total Crown operating expenses (excluding SOEs)	75,099		

**Crown entity and department procurement as a
% of total operating expenses (excluding SOEs)**

32%

(1) Grants & subsidies:

Non-reciprocal monetary and non-monetary assets or economic benefits provided to others. Includes overseas development assistance and local government grant but excludes Official Development Assistance paid by MFAT.

(2) Fees paid to audit firms:

Expenses paid to the entity's auditors for tax services as well as audits and other assurance services (includes probity audits and internal audits).

(3) Inventory expenses:

Expenses arising from distribution, write-off or other losses of inventory and inventory held for distribution.

(4) Rental and leasing costs:

The cost of renting and leasing items such as property and equipment under operating leases.

(5) Other operating expenses:

Includes everything not included elsewhere in the Crown financial statements. That is, it excludes - in addition to the above items - social assistance grants (BOUEs), Kiwisaver subsidies, official development assistance, personnel expenses, depreciation and amortisation, interest, insurance, deposit guarantee scheme expenses, impairments and write-downs of financial assets, lottery prize winnings, losses on financial instruments and losses on non-financial instruments (e.g. losses on GSF and ACC liabilities, PP&E, agricultural and intangible assets).

